



GOVERNOR'S OFFICE OF
BUDGET AND PROGRAM PLANNING

Fiscal Note 2009 Biennium

Bill #	SB0489	Title:	Constitutional amendment, allow investment of public funds in corporate stock
Primary Sponsor:	Cocchiarella, Vicki	Status:	Third Reading - Revised

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|---|---|--|
| <input type="checkbox"/> Significant Local Gov Impact | <input type="checkbox"/> Needs to be included in HB 2 | <input checked="" type="checkbox"/> Technical Concerns |
| <input type="checkbox"/> Included in the Executive Budget | <input checked="" type="checkbox"/> Significant Long-Term Impacts | <input type="checkbox"/> Dedicated Revenue Form Attached |

FISCAL SUMMARY

	<u>FY 2008 Difference</u>	<u>FY 2009 Difference</u>	<u>FY 2010 Difference</u>	<u>FY 2011 Difference</u>
Expenditures:				
General Fund	\$0	unknown	unknown	unknown
Revenue:				
General Fund	\$0	unknown	unknown	unknown
Net Impact-General Fund Balance:	<u>\$0</u>	<u>unknown</u>	<u>unknown</u>	<u>unknown</u>

Description of fiscal impact:

SB 489 submits to the qualified electors of Montana an amendment to Article VIII, Section 13, of the Montana Constitution to allow up to 25% of certain public funds to be invested in private corporate capital stock.

FISCAL ANALYSIS

Assumptions:

1. The constitution currently permits unlimited investment of pension funds in common stock and up to 25% of the State Fund in common stock. All other public funds, including the major trusts may not be invested in common stock. SB 489, if approved by the voters, would permit the Board of Investments (the Board) to invest up to 25% of state trust funds in private corporate capital stock, defined in state law as the common stock of a corporation.
2. The only state funds that would be prudently eligible for these investments are those state trusts that are constitutionally protected from appropriation and therefore have long investment horizons. These trust and their current invested book values are:

The Permanent Coal Tax Trust	\$531,703,269
The Treasure State Endowment	\$144,953,431
The Treasure State Regional Water Endowment	\$31,644,468
The Big Sky Economic Development Fund	\$27,852,550
The Resource Indemnity Trust	\$100,023,109
The Tobacco Trust	\$68,536,894
The School Trust	\$432,415,554

These trusts are currently participants in the Trust Funds Bond Pool (TFBP), which functions similar to a mutual fund. The TFBP invests in corporate and government bonds and distributes approximately 5.5% per annum income to the participants. Should the voters approve this constitutional amendment, the Board, if prudent to do so, would begin selling the trust's TFBP shares and utilize new revenues in the accounts to purchase shares in the Montana Domestic Equity Pool (MDEP), which also functions similar to a mutual fund. The MDEP invests in Large-Cap, Mid-Cap, and Small-Cap domestic stock and has as its benchmark the Standard & Poors' 1500 Index. Trust investments in the MDEP would result in immediate broad diversification.

The MDEP distributes dividends but retains all capital gains and losses. Replacing TFBP investments with MDEP investments would reduce current income to the trusts by the difference between the income generated by the TFBP and the dividends distributed by the MDEP. Dividend distribution can range anywhere from 1% to 2%. However, given that stock investments are expected to appreciate over time, while bond investments do not, future trust income would likely increase as the value of MDEP investments appreciated and were sold realized capital gains captured. Realized capital gains cannot be used to "grow" these trusts because by law all income, including any realized gains are appropriated by the Legislature. (5% of the School Trust income remains in the corpus.)

3. Because the timing of trust fund stock investments is uncertain and may depend upon market conditions at the time, it is difficult to estimate meaningful cost/benefits in actual dollar amounts. The investments would likely be made incrementally on a periodic basis to employ a "dollar cost averaging" process.
4. The following table summarizes the previous assumptions.

Public Fund Investment	Distributable Revenue
Current Asset Interest	
100% Bonds interest	5.50%
Proposed Asset Mix	
At Least 75% bonds interest	5.50%
Up to 25% Stock dividends	1%-2%
capital appreciation retained	unknown
sale of appreciated stock	unknown
Long Term Average Rate of Return	greater than bond income

5. Any reduction in current income would affect beneficiaries differently, depending on the type of beneficiary. The permanent coal trust and earnings are deposited in state general fund. Investment income from the other eligible trusts fund grants. Interest earnings from the permanent school trust are deposited into the guarantee account. The guarantee account is the first funding of school district BASE aid, and decreases to the guarantee account increase general fund expenditures needed to fund school BASE aid.
6. It is assumed that the Board will invest assets so that the current income needs of the trust beneficiaries will be met, while still capturing the benefits of stock investments. There would be no additional operational costs for the Board to invest the trusts in common stock.

Long-Range Impacts:

1. While in the short term, current income will be reduced, in the long term, if historical investment performance repeats, trust fund income may increase in the future because aggregate stock values are expected to appreciate, while bond values do not.

Technical Notes:

1. The bill's title has been changed from ~~all~~ to certain public funds while section 3 was not changed.

Department of Natural Resources and Conservation

2. Relative to the school trust funds, the amendatory language currently proposed in SB 489 goes beyond the stated purpose of allowing investment of up to 25% of the school funds in stock. By striking Article VIII, Section 13(2) in its entirety, SB 489 also removes existing constitutional protection requiring safe and conservative investment of the remaining 75% of the school trust funds in public securities of the state, bonds of the United States or other securities fully guaranteed as to principal and interest.

SB 493 from the 2001 legislature also proposed a constitutional amendment to allow public funds to be invested in stock. SB 493 contained language that allows investment of the school trust funds in stock without removing existing constitutional protection for those funds not invested in stock.

Article VIII, Section 13: (2) The public school fund and the permanent funds of the Montana university system and all other state institutions of learning shall be safely and conservatively invested in:

- (a) Public securities of the state, its subdivisions, local government units, and districts within the state, or
- (b) Bonds of the United States or other securities fully guaranteed as to principal and interest by the United States, or
- (c) Such other safe investments bearing a fixed rate of interest as may be provided by law that a prudent expert acting in a fiduciary capacity and familiar with the circumstances would use in investing a fund guaranteed against loss or diversion. (SB 493, 2001 Regular Session)

3. The school trust funds are guaranteed by the State of Montana against loss or diversion, pursuant to Article X, Section 3 of the Montana Constitution. SB 489 makes no provision for state compensation of the trust funds for the loss in stock value.
4. Section 17-6-201(2)(b), MCA currently prohibits investment of public funds, other than retirement funds, in common stock.

Montana State Fund

5. SB 489.02 amends Article VII, section 13(1), of The Constitution of the State of Montana and creates inconsistencies. Current language that is not amended by the bill references "...public funds and public retirement system and state compensation fund assets...". The amended language in section 13(1), notes only the "public funds" to be invested in stocks, and does not address investment of "assets" in stocks. A potential interpretation could be that state fund assets may no longer be invested in stocks. Since the provision for state fund assets has previously been passed by voters through a constitutional amendment, it does not need to be removed.

6. SB 489.02 amends Article VII, section 13(4), of The Constitution of the State of Montana. Language currently in section 13(4), provides that state fund assets are to be managed as would be used “in the conduct of a private insurance organization”. This provides for recognition of the unique nature of insurance in managing risk, including investment risk, to ensure a focus is on an insurance organizations ability to secure the assets to pay claims as they come due. However, that language will be deleted by passage and approval of SB 489.02 and only general investment language would then apply to the state fund.

Sponsor's Initials

Date

Budget Director's Initials

Date